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SUBMISSION

TO

THE ONTARIO COMMITTEE ON TAXATION

BY

RETAIL COUNCIL OF CANADA

TORONTO
FEBRUARY, 1964

Retail Council of Canada,
159 Bay Street,
Toronto 1, Ontario

The Chairman and Members,
Ontario Committee on Taxation,
Toronto, Ontario.

The Retail Council of Canada is a non-profit organization which was incorporated in June 1963 for the purpose of representing its members to government, public bodies, other industries and the general public.

Between them the Council's members transact approximately 30% of the retail "store" trade carried on in Canada. Its members constitute a cross-section of all except the smallest volume classifications within the industry. A majority of its members were formerly direct members of the Canadian Retail Federation. The latter body is now inactive.

Taxation at the federal, provincial and municipal level is a subject of considerable concern to the industry. Indeed, because of the variety of taxes which can affect it, its sensitivity to the climate and forms of taxation is probably greater than is that of a great many other industries.

In this submission the Council has made some comments on basic taxation principles and the inter-relationship of federal, provincial and municipal taxing policies. It has also reviewed the major existing sources of provincial and municipal revenues and possible additional sources. In the Council's view the frame-work of the present provincial and municipal systems is not unreasonable. The Council's strongest conclusions are that: (1) extravagances in government spending at both the provincial and municipal levels are evident and should be curbed; (2) neither the province nor municipalities should look to high rates of sales tax to overcome present or future revenue shortages; and (3) at least part of the heavy load which educational costs at present place upon the shoulders of real estate owners, particularly urban real estate owners, should be transferred to individual taxpayers.

The Council believes that none of the major forms of taxation which are not utilized at present within the Province, such as a capital gains tax, a value added tax, etc., could be introduced without deleterious effects. For this reason, the Council believes that whatever enlarged

fiscal needs may emerge must be satisfied within the limits of our present tax frame-work. The Council is, of course, hopeful that economies in the spending of both the provincial and municipal governments, if they do not actually reduce revenue needs, will at least keep them within bounds and that an expanding economy will generate an increased tax flow.

GOVERNMENT EXPENDITURES

Taxation is a means of raising the funds spent by government. It therefore seems appropriate to preface discussion of the taxation system with some comment on the purposes to which tax revenues are put and the manner of their disbursement.

Pressures for spending are always being exerted on governments. Often the pressures are generated because there is a genuine need for government action or participation. Just as often the pressures are produced by desires which may be strong within the pressure group but are not shared by the bulk of the population. Throughout this country all levels of government seem increasingly liable to accede to the latter as well as the former type of pressure. The governments within Ontario have been no exception to this general rule.

Because the administrative departments of government must, of necessity, have more checks and balances built into their structures, they have difficulty in achieving the agility possessed by profit-motivated organizations. Parkinson's law may have been conceived in jest but there is universal acknowledgment it contains a germ of truth.

Later in this submission it is suggested that optimum economic efficiency requires that "resources should be employed in public use to the point where their marginal net return in such use declines to the point where it is no greater than the marginal return on their use in the private sector". In the Council's opinion there are many instances where resources are employed in the public sector well beyond the point of maximum utility. The Council believes it is by no means unusual for all levels of government within the Province to indulge in unnecessary and wasteful spending.

Extravagances in spending are most readily discernible in public buildings because the latter are large and permanent objects with which almost every citizen comes in contact. Naturally, the Council wishes to see provincial and municipal departments housed in adequate quarters. Similarly, it is anxious that students throughout the Province receive a high standard of education in healthy and congenial surroundings. It strongly believes, however, that neither public buildings nor schools should be built in the unnecessarily lavish style which has characterized many such buildings erected within the Province in recent years.

Unnecessary governmental expenditures in other fields do not produce such tangible or permanent evidence of extravagance. The Council believes, however, that it is just as necessary to curb waste in these areas also.

Undoubtedly one of the sources of such extravagances is the division of responsibility for the making of spending decision between different levels of government. The Council alludes to this situation and makes some suggestions for its cure below. If the situation is remedied and if more effective controls on expenditures can be devised, the Council believes that savings of very significant proportions would result. The Council also believes that governments can do much in publicizing the tax costs of expensive and, in many areas, unnecessary projects which have been suggested and which it is alleged are demanded by the voters. Publicity of this nature would make unjustified demands much easier to resist.

CRITERIA FOR JUDGING A TAX SYSTEM

In its submission to the Federal Royal Commission on Taxation the Council had some comments to make on the criteria for judging a tax system. The Council's views are set out in Appendix "A" to this submission. The Council believes that these views are in many respects applicable at the junior levels of government. It recognizes that at the provincial level and even more at the municipal level taxation policies cannot and should not be framed with a view to achieving the broad economic purposes which of necessity must be formulated by the Federal Government and implemented by federally-controlled taxes.

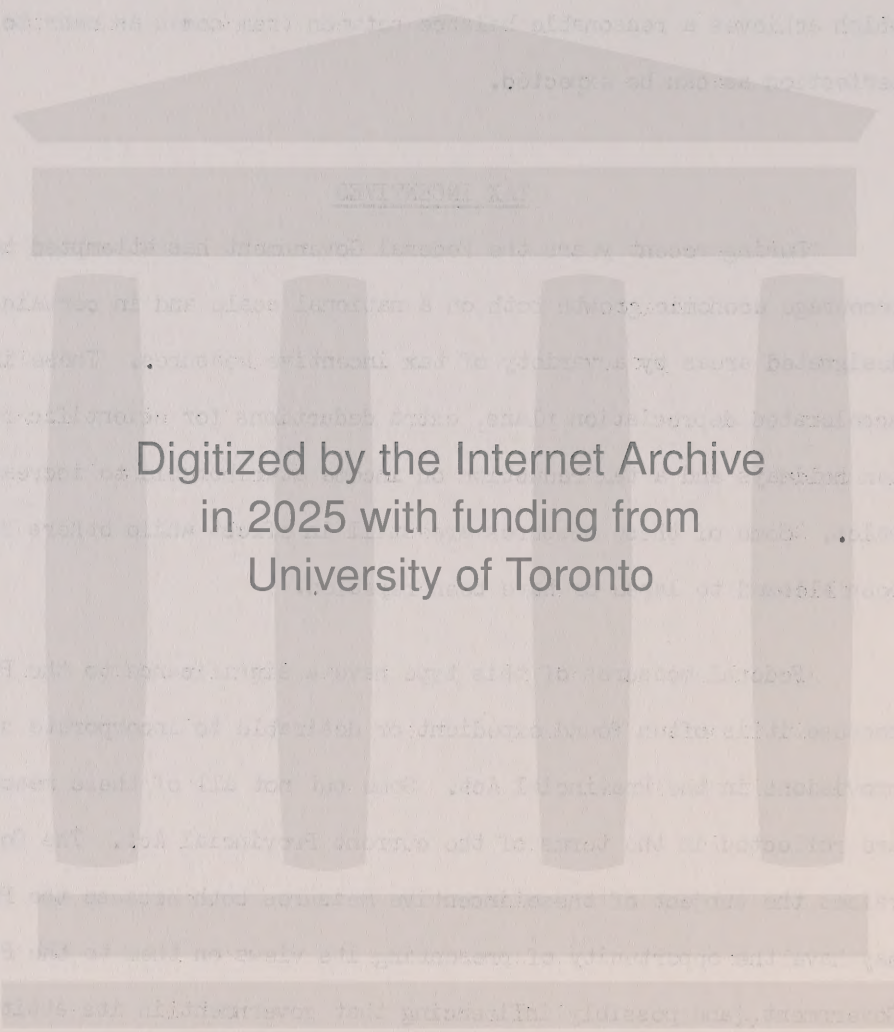
We believe that the objectives of federal and municipal taxation policies should be to raise the revenues required for the expenditures of the local government in a manner which (a) does not run at cross purposes with federal taxing policies, (b) is equitable as between the taxpayers in the region, (c) involves as little overhead cost as possible, and (d) places the minimum hindrance on the economic expansion of the area and the prosperity of its citizens. To achieve perfection in all these areas is of course impossible. In the Council's view, a taxing system which achieves a reasonable balance between them comes as near to perfection as can be expected.

TAX INCENTIVES

During recent years the Federal Government has attempted to encourage economic growth both on a national scale and in certain designated areas by a variety of tax incentive measures. These include accelerated depreciation plans, extra deductions for scientific research, tax holidays and a tax reduction on income attributable to increased sales. Some of these measures are still in effect while others have been allowed to lapse or have been repealed.

Federal measures of this type have a significance to the Province because it is often found expedient or desirable to incorporate similar provisions in the Provincial Act. Some but not all of these measures are reflected in the terms of the current Provincial Act. The Council raises the subject of these incentive measures both because the Province may have the opportunity of presenting its views on them to the Federal Government (and possibly influencing that government in its attitude) and because the Province may be tempted to devise incentive measures of its own.

It is too early to assess the effect of any of the existing measures in stimulating economic activity. Furthermore, we suggest that such a task would be one of great complexity involving as it must some attempt to predict the possible trend that business decision making would have taken had these provisions not been enacted. Nor is it possible to calculate the cost of granting such incentives.



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In its submission to the Federal Royal Commission on Taxation the Council made some remarks regarding incentives which it considers equally relevant in the present context. The text of these remarks is set out in Appendix "B" to this submission.

In its submission to the Federal Royal Commission the Council urged the substitution of a lower corporate tax rate in place of incentives, concessions to co-operatives, etc. If such a reduction in rates is made it is the Council's hope that the benefit will not be lost by the Provincial Government either introducing its own incentive schemes or by increasing its corporate rates.

FEDERAL-PROVINCIAL TAX-SHARING

The Council is aware that, in determining its attitude towards negotiations with the Federal Government, and through the Federal Government with other provinces, on the subject of tax-sharing, every province has two considerations in mind: (1) a desire to secure the most advantageous taxation settlement for the citizens of the province, and (2) a desire to reach agreement in a manner which will not prejudice and if possible will enhance feelings of national unity. As a national organization, the Council obviously is not in a position to comment on the first consideration other than to recognize its existence. It believes that the second consideration looms increasingly large in the thinking of provincial legislators and it applauds this attitude.

The Council does not feel itself to be in a position to tender advice on the degree to which the Province should participate in each form of tax levied by the Federal Government. It does, however, have some general comments to make on the subject of tax co-ordination.

1. Co-ordination of Policies: The Council believes that every effort should be made to co-ordinate federal and provincial taxing policies through the agency of the Federal-Provincial continuing committee on fiscal and economic matters. Particularly does the Council believe that it is important to ensure that deliberate changes in tax rates introduced by the Federal Government will not be cancelled out by the actions of the Provincial Government. It may be that to make its work effective this committee should be provided with a technical research staff.

2. Collection Procedures: It is the Council's belief that the Federal sales tax can be most efficiently collected at the manufacturers' level. As mentioned later, it believes that the problems of collecting a relatively high level of tax at retail and the probable adverse economic effects of a tax shift outweigh whatever savings might be achieved from the utilization of combined Federal-Provincial collection arrangements at the retail level, even if unanimity on a retail tax base could be arrived at by the Federal and every Provincial Government. The Council examined these questions in detail in its submission to the Federal Royal Commission on Taxation. The full text of its comments is set out in Appendix "C". In the light of its views on this subject, the Council does not propose to explore the possibility of establishing combined Federal-Provincial collection procedures for sales taxes. However, in the fields of corporate income tax and succession duties, we believe that centralized collection arrangements would make for significant savings. It recommends perpetuation of the use of centralized collection procedures for individual tax.

3. Exemptions from Federal tax of provincially-owned enterprises: The Council believes that the Federal tax exemptions provided to provincially-owned enterprises are not justified and render it attractive for provincial governments to take over privately-owned enterprises. The effects of such tax remission are particularly evident where the provincially-owned enterprise is in competition with fully-taxed investor-owned businesses. Even where this situation does not occur, the effects are unfortunate because erosion of the tax base occurs and the tax rates of all other businesses are increased. The Federal Government has recognized that serious side effects result when Crown corporations engaged in business are exempted from tax, and income tax is now collected from these corporations. The Council believes that the Provincial Government should urge similar action on the Federal Government in the case of provincial corporations.

FEDERAL GOVERNMENT GRANTS IN AID AND CONDITIONAL GRANTS

The number and size of conditional grants made by the Federal Government to the provinces seems to grow yearly. Often the grants are made in areas where the spending responsibility lies exclusively with the province under the terms of our Constitution . The programmes covered by the grants are those in which the Federal Government feels that uniformity of action by the provinces is desirable or in which attainment of the objectives sought would benefit the economy of the nation as a whole and, in either case, that the provinces are unlikely to be able to raise the finances to carry the project or projects to fruition. While the Council believes that many of the schemes have a worth-while purpose and that their implementation is of benefit to the people of the provinces where they are introduced, it feels that these circumstances do not obtain in every case. It believes that from time to time provincial governments are induced to participate in cost-sharing programmes because it would be politically unwise for them to refrain from such actions even although they may have doubts as to the benefits which any particular programme may have for their own province.

Another unfortunate characteristic of this type of expenditure is that control of the disbursements of the joint Federal and Provincial funds is often less strict than would be the control exerted over the spending of purely Provincial or purely Federal funds.

For these reasons the Council considers that it might be wise for the provinces to urge the Federal Government to restrict or abandon entirely the Federal grant in aid system and replace it with the flat grant to each province calculated with reference to that province's need. In situations where the Federal Government considered any particular programme absolutely essential to the well-being of the nation, then it still would be in the power of the Federal Government to pay the whole cost of the project itself.

GRANTS IN AID BY THE PROVINCE TO MUNICIPALITIES AND SCHOOL BOARDS AND THE ALLOCATION OF REVENUES FOR MUNICIPAL AND SCHOOL PURPOSES

As the variety and extent of services provided at the municipal level has increased there has, understandably, been a significant rise in the volume of revenue passing from the Province to municipalities. There has also been a corresponding increase in the number and variety of grants while the tests for municipal entitlement to grants become more diverse and complex.

Not surprisingly, in view of the increasing emphasis which is being placed on education in our society and the enormous expansion in physical facilities which has resulted, grants for educational purposes have constituted a large and growing proportion of the total grants made available to municipalities.

The present basis of financing education causes the Council some concern. So far as other types of municipal expenditure are concerned, the Council feels present methods of allocation of cost are not, in the main, unfair. (Later we shall refer to the treatment for taxation purposes of business property as compared to the treatment of residential and farm property.) Just as the division of federally-collected revenues among the provinces requires that there must be an element of subsidy by the richer provinces to the poorer provinces, the provincial-municipal grant system takes account of the relatively low tax-producing capability but the considerable need for services of the rural and more remote parts of the province.

If a heavy proportion of the cost of providing services such as streets, lighting and sewers falls on real estate, this is not unreasonable for such services are provided to benefit real estate owners. Nor in this instance is it unreasonable that the apartment dweller should be treated more leniently than the home owner; it is cheaper to provide such services to the former than the latter.

In the financing of education, however, an entirely different set of conditions exists. Particularly in urban areas education costs fall heavily on owners of real estate. The more valuable the real estate the larger is the proportion of education costs borne by the owner. It is

now a considerable time since the value of real estate holdings has been an accurate indication of a taxpayer's ability to pay. The proportion of income and capital which is devoted to the provision of housing varies widely between taxpayers in similar financial positions. A rich man may choose to live in a modest apartment building; several members of a family all enjoying comparatively high incomes may choose to live together in cramped quarters but spend heavily in other areas; a taxpayer with a modest income and a young family may curtail all other forms of expenditure so that his family can enjoy optimum living conditions. As a result of such circumstances, the taxpayer who chooses or is obliged to spend a relatively large proportion of his income on housing is charged with a disproportionately large part of the burden of education costs.

In some degree the disparity between the value of real estate owned and ability to pay is also apparent in the case of the ownership of commercial property. One industry, if it is to operate successfully, may require a heavy investment in valuable real estate. Another and more profitable type of business may not require to devote a large proportion of its assets to this area and so will make a much smaller contribution to education costs. To this extent the price patterns of the two types of business will be affected.

Possible Improvements in Present Financing Methods

The Council is not suggesting that real estate should not be charged with a substantial part of the costs of education; that there should not be some subsidization of rural areas by urban areas; or that ability to pay should be the sole determinant of the taxpayer's contribution to the costs of education. It is suggesting that the share of the burden of education costs falling on real estate owners is too high, particularly in urban areas.

The fact that real estate taxes are a traditional and accepted means of raising local revenues, including those which cover part of the costs of education, is a substantial argument for their perpetuation. Indeed, no alternative source for the whole of the huge volume of revenue raised in this way readily presents itself. The Council believes that the present situation could be improved -

(a) if the methods of making grants to municipalities for educational purposes were revised so that fewer extravagances in spending were induced; and

(b) if taxes other than real estate taxes were used to a greater extent to finance education.

For the purpose of inducing the highest source of responsibility in voters and - through them - school trustees, any new scheme of financing education costs would ideally result in most voters (and not simply the owners of real estate) making a contribution which was variable with local education costs. This would imply the establishment of differing municipal tax rates in whichever field of taxation was employed. The Council believes that administrative complications preclude the use of such a system and that it is necessary to collect the extra revenue at the provincial level.

The Council believes that economies would be induced if a reasonable proportion of grants were made to municipalities on a per capita basis and somewhat less emphasis was placed on grants related to the "assessment per pupil of average daily attendance" and other formulae of this nature. Complementary to this system would be the introduction of adequate control procedures. The Council does not propose to suggest the ratios in which such grants should be adjusted. It believes that experience with a rearranged system would enable conclusions to be drawn as to the most efficient mix of types of grant - optimum efficiency being achieved at the point at which extravagances were eliminated and educational services were maintained at an adequate level.

Neither does the Council propose to quantify the extent to which revenues from sources other than real estate taxes should be used to finance educational costs. Of course, the amount of tax revenues available for this purpose would be one of the determinants. Fields where the Council believes such revenues might be derived are in the extension of the sales tax to services and perhaps in the revenues derived from the minor tax sources. Economies in other areas of government spending would, of course, free revenues for use in the manner suggested.

The Council gave consideration to alternative sources of taxation which might be used in this field - such as poll taxes, fees for education, an increase in the individual income tax rate, and an increase in the general sales tax rate. It considered the use of all such sources undesirable. Poll taxes and educational fees would weigh heavily on the least affluent sections of society and probably a great many exemptions would require to be made. The Council has enlarged elsewhere in this submission on its attitude towards a substantially higher sales tax rate than that in use at present. It believes that individual incomes are already bearing a considerable share of the total tax burden.

CERTAIN EXISTING TAXES

Sales Taxes

The retail sales tax is now an established part of the Province's taxation system and it produces a significant proportion of the Province's taxation revenues. The possibility of the Province dispensing with the tax in the immediate future is thus probably remote. While the Council recognizes these factors, it also wishes to place on record its dissatisfaction with this type of tax as a class. The chief disadvantages of sales taxes are as follows:

1. Sales taxes contribute less built-in stability to the economy than nearly all other taxes. As one writer has put it - "Since World War II the bases of most property taxes, personal income taxes, and corporate income taxes have been more income-elastic than the bases of most retail sales taxes".

   (D.C. Morgan "Reappraisal of Sales Taxation - Some Recent Arguments", National Tax Journal, March 1963, page 100)

2. Because monetary policy can have only a limited effect in controlling economic fluctuations, particularly in a country heavily committed to international trade, fiscal policy is important. Built-in stabilizers prompt less opposition to counter cyclical budgeting than do changes in tax rates made for this purpose.
3. In addition, Canada has a structural as well as a cyclical employment problem. By favouring savings over consumption, sales taxes tend to reduce spending and employment. Efforts to increase savings may be

a virtue and are desirable when the economy is threatened with inflation, but when they contribute to unemployment they create hardship.

4. Sales taxes are "regressive" in that a higher percentage of low incomes than high incomes is taken in tax. The introduction of exemptions, such as on food, only reduces regressivity; it does not eliminate it. The more exemptions are permitted the greater become problems of enforcement. A wide number of exemptions also implies a higher rate of tax.

5. Sales taxes are "perverse". That is, families with equal incomes bear quite different tax burdens. For example, large families which must save less pay more sales tax than small families. Similarly, a young family spends heavily on furnishings, household equipment, and often buys a house, thereby spending much in excess of current income, and so will pay much more in tax than a family which has acquired these things.

6. Sales taxes are "capricious". The burden that a family of given size and income has to bear depends upon its tastes, or preferences.

7. Sales taxes are "uncertain". That is, they turn out to be a sort of mixture between a single-stage sales tax and a turnover tax, with some goods and services not being taxed at all and others taxed more than once - being taxed themselves and produced with taxed equipment or components.

The effect of these unfortunate characteristics is, of course, proportional to the rate of the tax. At very low levels of sales tax the distortions induced in the economy by such a tax are comparatively slight. Were the present provincial rate to be substantially increased, the Council believes that the distorting effect would be significant.

The Council is aware that the various levels of government in certain other countries have placed greater reliance on sales taxes of various types than do the federal and the various provincial governments of Canada. Some of these countries have been enjoying growth rates which in some years have exceeded those experienced in Canada. The Council believes it is fallacious to credit this particular aspect of their taxation systems for the prosperity they have enjoyed. Even more significant than the manner in which taxes

are imposed is the size of the total tax burden, and of course taxation is only one of the elements which go to make up an economic climate. It is by no means unreasonable to suppose that certain of these countries achieve their economic growth in spite of rather than because of their tax structures.

The Council is also aware that several business groups, in their appearances before this Committee, the Federal Royal Commission on Taxation and elsewhere, have advocated that sales tax rates be increased so that personal and corporate rates could be lowered. Such recommendations were prompted, the Council believes, not because such groups regarded sales taxes as having any intrinsic merit over other forms of tax but simply because business men were naturally concerned at the current high rates of personal and corporate taxes in force and because sales taxes presented the most readily discernible alternative source of revenue.

We have already commented on the difficulties which would be likely to result from an attempt to consolidate the Federal manufacturers' sales tax and the Provincial sales tax at the retail level. (Appendix "C")

The Specifics of the Ontario Retail Sales Tax Act and the Regulations thereunder

The Council recently had prepared for it a survey, the aim of which was to identify the features in provincial sales tax legislation which produce the greatest degree of equity in application and simplicity in administration. It was found that the Ontario tax measured up well to both these criteria. There were, however, certain areas where the Council felt some substantial improvements could be made.

Coverage

The Council feels that once a sales tax is introduced there is merit in providing as broad a coverage of consumer goods as is feasible and consistent with accepted standards of equity. Broad coverage offers several advantages:

1. A given amount of revenue can be raised by a lower tax rate than that required if exemptions are numerous. The lower the rate the less distortions are induced in the economy and the less are vendors of particular types of articles liable to lose sales.

2. Discrimination in favour of those persons who prefer to spend high percentages of their incomes on tax-exempt goods is avoided. Exemptions, however well designed, inevitably discriminate in favour of persons concentrating their expenditures on the exempt lines.

3. Virtually all exemptions and other exclusions from tax complicate the tasks of both retailers and the Province. It is extremely difficult to provide workable definitions of exempt categories which are clearly understandable and accomplish the desired results. Even if the definitions are themselves satisfactory, the attainment of uniformity of application by thousands of store clerks is extremely difficult, and both competitive disturbances and heavy assessments for uncollected tax result. If everything handled by a particular store is taxable the application of the tax is simplified.

4. Apart from the questions of interpretation and application there are the problems of recording and auditing the reported tax. If all sales, or almost all sales, are taxable, the task for the firm of keeping adequate records for sales tax purposes is relatively simple. We recognize, however, that social considerations require most governments, including that of this Province, to create certain exemptions.

Avoidance of Commodity Exemptions

For purposes of simplification the Council believes that in the application of any retail sales tax only three types of commodity should be exempted from the tax. These categories are:

1. Food
2. Drugs and medicines for external use and when obtained on prescription
3. Fuel

The areas where the present Ontario tax diverges from these criteria are:

1. The Definition of Food: While the Ontario Act meets the recommendation of the Council that food be exempted, it limits the definition of food so

that candies, other confections and soft drinks are excluded from the exemption and so are taxable. The Council believes that it is very difficult to arrive at acceptable definitions of candy and soft drinks and it is virtually impossible to ensure uniform application of the rules established. Further, these items are ones of very widespread consumption and involve "luxury" food spending no more and actually much less than many other food items such as expensive cuts of meat, exotic imported foods, etc. Related to this category is the treatment of restaurant meals. At present meals costing less than $1.50 are tax-free; those costing more than this level are taxed. It is considered that the limit is set at a somewhat low level in the light of present-day costs. The Council believes that the present limit might be set at $2.00 or $2.50 and adjusted in the future to keep pace with the cost of living.

2. Children's Clothing, Classroom Supplies, Books and Magazines: It is considered that the small amount of money which an average family saves through not being required to pay tax on these commodities scarcely justifies the problems of administration and compliance which result from their exemption. The Council believes that such categories of commodities should be subjected to retail tax.

3. Drugs and Medicines: For purposes of control it is suggested that drugs and medicines be exempt on prescription only. If the Council's suggestion regarding the definition of food is adopted and the "anything edible" rule is employed, then medicine for internal use would be exempt in any event. The prescription rule would only apply to external medicines. This is the field in which the provision of an exemption without a prescription requirement is the most troublesome.

Taxation of Services

Because the Ontario sales tax is applied exclusively to the taxation of tangible personal property, numerous rules are required for the drawing of demarcation lines between commodities and services when commodities are sold in conjunction with the rendering of services other than those of typical distribution functions. Many of these artificial rules could be eliminated with a somewhat broader coverage for the tax. One of the most important examples is provided by repair services. In an effort to avoid taxing the labour of repair as such, quite complicated rules are established and numerous questions of interpretation result. The same considerations apply to the installation of tangible personal property in real property.

While for reasons of general social and economic policy many services such as medical care, hospitalization, and ones rendered primarily for business use (such as engineering or management consulting services) are not suitable objects for taxation, there are a number of services which can very appropriately be included within the scope of the taxes. These include:

1. As noted, all repair services on taxable property
2. Installation of tangible personal property in real property
3. Laundry, dry cleaning and related services
4. Car lubrication, battery charging, towing and other garage activities
5. Repainting and refinishing of tangible personal property
6. Barber and beauty parlour service
7. Hotel and motel charges for transient accommodations
8. Film developing.

Not only would taxation of such services broaden the base of the tax and allow larger revenues but it would provide more equitable distribution of burden, since discrimination in favour of families concentrating their expenditures on services would be avoided and the tasks of the vendors greatly simplified. Virtually every business establishment rendering the types of services noted above either also sells tangible personal property or buys such property subject to tax. Overall operation of the tax would be tremendously simplified if the entire charge were taxable. The service establishments would

then be able to buy their parts, tools, etc., and materials used in rendering the service free of tax. (They, as in the case of all vendors, would be taxable on other purchases such as of office equipment, but the treatment of them would be the same as that of vendors in other businesses and a general simplification would result.)

The Mechanics of Collection

The Council believes that the collection system adopted by the Province is, on the whole, working well. It believes the efficiency of the system could be increased with an intensified audit programme. The Council believes that the Province's present audit staff is too small to cope with the volume of work with which it is faced. Failure to audit at sufficiently frequent intervals results in continued misapplication of tax, and thus not only creates competitive disturbances but may also result in large assessments (which cannot be passed on to customers in most cases), when the audit is finally made. Delayed assessments may also, of course, result in serious overpayments. It is the Council's recommendation that each vendor be audited at least every three years.

Individual Income Tax

The Council believes that the manner in which the Federal Government collects this tax on behalf of the Province serves as an example of the efficiency of this type of operation. The Council in its submission to the Federal Government has made suggestions regarding a selective reduction in the higher personal rates which the Council hopes would have the effect of reducing the flow of talented Canadians to the United States. If such action were to be taken by the Federal Government, the Council would hope that, as recommended elsewhere in the submission, the Province would not take any action in regard to its individual taxation policies which would conflict with Federal policies.

Corporation Income Tax

The Council believes that joint Federal-Provincial collection of this tax would be most desirable. Particularly does the Council believe that it is desirable for the two taxes to share the same base. The economies which would be experienced in maintaining only one instead of two collection agencies are obvious. Equally obvious is the fact that taxpayers would enjoy

the benefit of reduced compliance costs. We have urged to the Federal Royal Commission that the total tax burden on corporations be reduced rather than increased. Under present economic conditions, consolidation of collection procedures would still allow the Province to increase its share of corporate tax revenues if it felt this to be necessary. It is the Council's hope, however, that the Provincial Government follow the recommendations made elsewhere in this submission and refrain from taking action which would cancel out any relief given to corporations as a result of Federal Government policies.

The Council also believes that capital and place of business taxes should be discontinued. Such taxes are not major revenue contributors, while they fall with undue severity on marginally profitable businesses. Adjustment in the corporate rate could compensate for the loss of this particular revenue source.

Succession Duties

The Council believes that the duplication and uncertainty induced by the present methods of collection of succession duties and estate taxes in Canada represent urgent reasons for the Provinces and the Federal Government to seek diligently an acceptable means of levying a single, uniform tax. At present, Ontario revenue from succession duty exceeds the revenue that would be produced under the rental agreement proposed by the Federal Government. The Council has made proposals to the Federal Government that the exemptions should be increased to take account of the changing value of money and the increasing affluence of our society. If such alterations were brought about, the revenues from estate taxes would be decreased overall, and in these circumstances the Federal Government might be disposed to increase the rental payment of the duty to the Province to 100%. The Province would then be able to vacate the field without a serious loss of revenue.

In the event that the Province does not vacate the succession duty field, we would recommend that every effort be made to achieve uniformity with the Federal Act. We would also recommend -

1. A basic exemption from tax for estates under $100,000.00;
2. In cases where there is a surviving spouse, the basic exemptions should be the greater of -

   (a) $100,000.00

(b) One-half the combined estates of both the husband and the wife, to a maximum exemption of perhaps $200,000.00;

3. Exemptions for children should be increased and should recognize the greater needs of younger children, perhaps on a sliding scale to age 21.

The Council is particularly concerned about the problem which is created when the large part of an estate consists of shares in a private company. In many cases the requirement to pay estate tax results in either a forced sale of family business or the payment of substantial income taxes on funds withdrawn from the company to meet the tax liability. While this problem would be relieved to some extent if the Government were to accept our recommendations with respect to increased exemptions, we believe that the Committee should give some consideration to this problem and perhaps devise a method whereby succession duties might be paid over a number of years under certain circumstances.

The Council also recommends that the Act be amended to permit the use of a valuation date other than the date of death. This would permit the use of a valuation date which would be closer to the date at which the executors would be free to dispose of the assets of the estate in order to meet the tax liability or other requirements of the estate. Accordingly, we would suggest that the valuation date shall be the date of death, but that the executors be permitted to elect to value the estate twelve months after death. If such an election was made, the value to be placed on assets disposed of during the period would be the realized value.

This provision would be helpful in arriving at the value to be placed on investments in private companies, particularly when these investments must be sold by the estate. It frequently happens that such investments are now being sold soon after death but for amounts substantially less than the determined value on the date of death. This we believe imposes an unnecessary hardship upon the estate.

The Council also endorses the proposals made to the Committee by the Institute of Chartered Accountants of Ontario in regard to determination of aggregate value, the taxation of transmission of property situated in other provinces that have rented this field to the Federal Government, and the treatment of Ontario property owned by foreign persons who die domiciled abroad.

Gasoline and Fuel Taxes and Vehicle and Driver Licensing Fees

Historically in Canada an attempt has been made to fix gasoline and fuel taxes at levels where they will meet or come near to meeting provincial expenditures on roads and highways. It is understood that in Ontario revenues currently derived from these taxes exceed expenditures on roads and highways. As a result, such taxes at these present levels are probably now more properly regarded as part of the Province's general revenues.

Expenditures on licences and fuel for commercial vehicles are obviously made for commercial purposes. It is not possible, however, to determine accurately what proportion of private vehicle use is made for business purposes. The proportion is probably a reasonably high one. To the extent that licensing and fuel taxes are met by business they represent an additional tax element in the costs of production and distribution and have consequent repercussions on the cost of products produced and consumed in the Province.

Every resident of the Province is to a varying degree not only a highway user himself but is dependent on his suppliers of services also using the highways. An additional consideration affects expenditures on communications within Canada. Because of this nation's great size and sparse population, expenditure on communications in general and on roads and highways in particular is likely to remain above the level common to most other countries which have reached a comparable level of maturity. From the earliest days of Confederation the Federal Government recognized that it had a responsibility to assist in the development of all forms of communication in an attempt to overcome, in part, the divisive effects of distance. The Council believes that that obligation of government has not ceased and that, while primarily a Federal responsibility, the obligation is evident at the provincial level also.

To the extent that road users are paying more than their share of the costs of maintaining the Province's roads and highways the competitive position of other transportation media is being improved. For these reasons the Council believes that it would be most undesirable if these taxes were raised. For similar reasons the Council sees no reason for the Province to adopt toll charges on particular roads or highways.

Assessment of Real Estate and Business Taxes

In Ontario real estate is assessed at actual value or a percentage thereof and business tax is assessed at a percentage of the real estate assessment. The Council believes that this system is reasonably sound in principle and it does not suggest that it be radically changed. We do have some comments to make on the manner in which the system is applied.

Assessment of Real Estate

(a) Determination of Value: At present municipal assessors base values on those prevailing during a particular year in the past. The year chosen varies throughout the Province and this situation breeds confusion. The Council recommends that the recommendation in this respect of the Select Committee which considered revisions to the Municipal Act and related acts be followed. The Committee's recommendation was:

> That assessment of land and buildings should be based uniformly throughout the Province on a three to five year period of recent values rather than a base year selected by the municipal assessor, as at present.

(b) Treatment of Commercial as compared to Residential Real Estate: A considerable disparity exists between the tax rates applicable to commercial and industrial property and those applicable to residential or farm property. The terms on which provincial grants are made to municipalities are largely responsible for the phenomenon. In the view of the Council there is no sound basis for creating discrimination of this type. The Council appreciates that elimination of the disparity would throw a heavier burden on residential real estate owners. If the Council's suggestions regarding other tax sources are adopted, however, it might be possible for residential owners to absorb that portion of the commercial property owners' tax burden which should not properly be theirs and still enjoy a reduced assessment.

(c) Appeal Procedures: The Council believes that present appeal procedures are unsatisfactory. Again it suggests that the recommendations of the Select Committee be followed. The Select Committee's recommendations in this area were:

(1) That a special tribunal should be set up to hear assessment appeals to consist of impartial persons qualified in assessment and appraisal work; and

(2) That appeals to the Supreme Court of Ontario on questions of fact as well as law be permitted.

Assessment for Business Tax

At present the Assessment Act prescribes a long list of percentages which are to be applied to real estate values in the calculation of the business tax liabilities of various types of business. The variable percentage system presumably constitutes an attempt to link a business' business tax liability (a) to the average profitability of the industry and (b) to the value of the real estate it occupies. The Council recognizes that any attempt to estimate the average profitability of an industry and assess individual members of the industry on that basis must inevitably result in substantial inequities. Furthermore, it believes that present tax percentages are by no means an accurate reflection of the profitability of the listed industries. It suggests that it would be more equitable to restrict the number of business classifications. If a system of limitation is adopted, it is suggested that the levels be set at 25%, 50%, 60% and 75%, parking areas being classified in the lowest category.

PRICING POLICIES OF PROVINCIAL ENTERPRISES

The Council believes that government participation in commercial enterprises should be restricted to fields which for strong social reasons are unsuitable for development by private capital. The operation of provincial parks is an example of an area where provincial activity is in the opinion of the Council quite justified. Operations of this type may involve the setting of charges to the users of the services. In such situations, normal pricing criteria are obviously not appropriate. If on the other hand the Province enters fields where it is competing with investor-owned business and there are no social considerations affecting the prices and charges, then the Council believes the Province's pricing policies should follow normal commercial practices and in particular should make full provision for the cost of money employed in financing the operations.

ALTERNATIVE SOURCES OF REVENUE

Various suggestions have been made as to possible alternative fields of taxation which the Province or municipalities might exploit. The Council's views on these alternative sources of revenue are:

Gross Receipts Tax

This tax is presumably suggested as an alternative or partial alternative to the corporation tax or to increased corporate rates. In the view of the Council the disadvantages of this type of tax outweigh its advantages. To the extent that the tax is passed on in increased prices it has inflationary tendencies; to the extent that it is absorbed by the business it becomes a business expense and one which will weigh much more heavily on a marginally-profitable or a new business than on an established, successful one. The tax does have the advantage of falling evenly on all forms of business enterprise whether organized as single proprietorships, partnerships or co-operatives. In the view of the Council this advantage does not outweigh the drawbacks.

Payroll Tax

The Council believes that this tax suffers from a flaw which in the context of Canada's present economic climate is sufficiently grave to preclude introduction of the tax being seriously considered. A tax of this type discriminates against industries and businesses which are labour intensive and favours those which are capital intensive. It will be recalled that at a time when Britain appeared to be threatened with a labour shortage the British Government introduced legislation which enabled the government to establish a payroll tax by statutory order. It was felt a payroll tax would greatly stimulate the introduction of labour-saving devices and reduce the pressure on the labour supply. In an era when Canada is faced with the obverse of this problem the suggestion that this type of tax be introduced would seem to be quite unacceptable.

Net Wealth Tax

The Council believes that in a country which suffers from a continuing capital shortage introduction of a tax which penalizes the accumulation of savings during the lifetime of the taxpayer would be an

unfortunate step. Under our present taxation system accumulations of wealth are effectively taxed either by means of the gift tax or by succession duties. The Council believes that these taxes represent the least harmful means of deriving revenue from capital. The one taxes capital which, as evidenced by the fact that he is disposing of it, the donor feels he no longer requires. The other generally taxes wealth at a time when the taxpayer has had the opportunity of providing against the eventuality. A net wealth tax, on the other hand, would probably act as a deterrent to the accumulation of small savings and would fall with most severity upon the investors in small businesses. Such enterprises are generally characterized by chronic capital shortages. A net wealth tax would serve to intensify this problem. A tax of this nature also involves continual valuation problems and presumably the costs of collection would be high.

Personal Property Tax

Most of the disadvantages associated with the net wealth tax also affect this type of tax. It may be argued that as the ownership of real estate is heavily taxed it is not unreasonable to apply a measure of tax to the ownership of personal property also. However, it is the Council's view that the taxation of real estate can be distinguished (1) because a considerable portion of the revenues raised from real estate taxation is devoted to meeting the costs of servicing the real estate and (2) because real estate taxation has been applied for such an extended period that the economy is to some extent adjusted to its existence. The Council has, of course, pointed out elsewhere that very high real estate taxes do induce inequities. It believes that these inequities can best be adjusted by means of ~~income~~ taxes other than capital taxes.

Stock-in-Trade Tax

This is another form of tax which discriminates unfairly between different types of business. Some businesses require to operate with heavy inventories, some with light. Some service industries require no inventory whatsoever.

Turnover Tax or Value Added Tax

The Council believes that, to the extent that these taxes are

introduced in substitution for corporate taxes, they are inflationary in tendency. The turnover tax is discriminatory against high volume - low profit operations, while the recent British studies of the value added tax support the view that it is discriminatory against labour intensive industries. To a degree, both types of tax are probably also liable to stimulate artificially the vertical integration of businesses, although this characteristic would be particularly evident in the case of a simple turnover tax.

Utilities Tax, Water Tax

The Council feels that introduction of these taxes would have an unfortunate effect on the economy. If the services were only consumed by households, imposition of a retail sales tax on them might be justified, if the tax were at the same time extended to cover all other services. However, these services are extensively consumed by business and industry. Taxes imposed on services to these sectors would create double taxation in that both the tools of production and the finished product would be taxed. The Council believes that this eventuality should be avoided. It would probably be extremely difficult to introduce taxation on utility services to private households and exempt similar services provided to industry. The pressure for the granting of relief to individuals would be very strong. For these reasons the Council recommends that no tax be imposed on the provision of utilities or water.

Capital Gains Tax

The imposition of a capital gains tax does present superficially at least certain attractive features. There is no essential difference between ordinary income and a capital gain. Absence of a capital gains tax may introduce artificial criteria into investment decisions. As the law is presently framed there is bound to be continuing uncertainty as to whether a profit falls within the capital or the income classification.

However, the Council believes that this form of tax has disadvantages sufficiently grave to lead the Council to recommend against its introduction. The other considerations can be summed up as follows:

1. Equity: For administrative reasons it is generally agreed that capital gains can be taxed only when they are realized. This creates an immediate problem when a comparison is made between a taxpayer who, for reasons of necessity or prudence makes changes in his investment portfolio, and the investor who retains his investment portfolio unchanged until death. The former would make himself liable for a capital gains tax which could have been avoided or postponed simply by retaining the appreciated investment. The latter would, on the other hand, escape capital gains tax entirely, although the amount of the overall gain in each portfolio might be comparable.

It should also be kept in mind that taxpayers face estate taxes and succession duties on death which effectively tax accumulations of wealth.

Finally, it has been argued that, since capital gains may accrue over a number of years, they should not be taxed at progressive rates in the year in which they are realized. Supporters of capital gains taxation then propose that capital gains be taxed at a flat rate of tax. (The United States taxes long-term gains at the flat rate of 25%.) The use of such a flat rate does not, in our opinion, result in any greater equity in the distribution of the tax burden, since all gains large or small accruing to wealthy taxpayers or to those of more modest means would be subject to the same rate of tax.

2. Tax revenues: While the Council has made no attempt to estimate what additional revenue might be realized by the imposition of a capital gains tax, we do not believe that it would be significant provided the rates of capital gains tax were reasonable. This is largely because:

(a) Many speculative gains which are now taxed as ordinary income (for example certain real estate profits) would presumably be subject to the lower capital gains tax in future.

(b) Initially at least, we would expect that the return on a tax comparable to the present U.S. capital gains tax would be less in Canada since the valuation base would be the current value. In the U.S., however, tax is imposed on all gains accrued since 1913.

We would expect that revenue from a capital gains tax could be extremely unpredictable at least for the first several years after its imposition. It is not inconceivable that, during a year of economic slowdown, a capital gains tax might result in a net revenue loss if capital losses were to be allowed as an offset against other income.

3. Administration: While it has been argued that the imposition of a capital gains tax, together with a statutory definition of capital gains, would allow taxpayers a greater degree of certainty in determining their tax liability, we believe that definition problems would continue to exist as long as capital gains were to be taxed at rates lower than other income. In support of this submission we would direct the Commission's attention to the substantial number of regulations, legislative provisions and tax cases on this subject alone in the United States. In countries imposing capital gains tax, the general approach has been to distinguish capital gains from ordinary income by reference to the length of time that the particular asset has been held. We believe that this approach is necessarily arbitrary. Furthermore it permits taxpayers to reduce substantially their tax otherwise payable simply by retaining a speculative investment for longer than the stipulated period.

In addition, the taxation of capital gains raises further administrative problems, not only for the Department of National Revenue but also for most taxpayers who would be required to prove not only the selling price of all assets sold during the taxation year but also the price at which these assets were originally acquired. This would be particularly difficult when determining the tax liability of individual taxpayers in respect of gains realized from the sale of real property, particularly in cases where the property had been held for a number of years and substantial alterations or changes had been made. We believe that this situation would apply to a very large number of taxpayers.

4. Economic impact: It would be difficult to assess the economic impact of a capital gains tax. It is reasonable to assume, however, that it would impose additional artificial tax considerations into investment decisions. It is also reasonable to assume that capital gains taxes, to the extent that they arise from investment transactions, would be paid from funds that would otherwise be available for equity investment purposes. To this extent, the imposition of a capital gains tax would appear to be contrary to the stated government policy of encouraging investment by Canadians in the ownership of Canadian enterprise.

In conclusion, the Council believes that the imposition of a capital gains tax at this time would result in enormous problems of administration and enforcement without significantly altering the present distribution of the burden of taxation, and without a significant increase in tax revenues. Accordingly, we do not recommend that such a tax be introduced in Canada.

All of which is respectfully submitted on behalf of Retail Council of Canada by

A. Y. Eaton, President

A. J. McKichan, General Manager

A P P E N D I X "A"

Excerpt from Submission of Retail Council of Canada to Federal Royal Commission on Taxation on the Topic of Criteria for Judging a Tax System

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Canada's tax system must be considered in relation to criteria for judging its worth. The views of the Retail Council of Canada are expressed with the following features of the tax system in mind:

(1) equity,

(2) effect upon the allocation of resources,

(3) effect upon economic stability, and

(4) administration of the system.

All except (3) are long-standing criteria by which tax systems have been judged; (3) is of more recent origin associated with the acceptance of modern governments of responsibility for moderating fluctuations in the level of economic activity.

There are two dimensions to equity in taxation. One is the extent to which persons of equal tax-paying capacity are required to pay the same amount of tax. Income is obviously an important determinant of capacity to pay taxes. Besides income, other characteristics affect tax-paying capacity - e.g. wealth. Where two individuals receive the same income, one possessing far greater wealth than the other would obviously have greater tax-paying capacity.

The second dimension of equity in taxation concerns the respective shares of taxation which individuals with different tax-paying capacities should bear. All taxes, whether levied upon individuals, businesses in general, or corporate businesses in particular are ultimately taxes upon individuals or the families or households into which they are organized. It is generally accepted that as income and wealth increase, tax-paying capacity increases more than proportionately. The tax system therefore should be progressive in respect to these characteristics.

Taxes impinge upon resource allocation in several ways. On the one hand are effects which relate to individuals' productive efforts - the division of their time between production and leisure, the division of productive efforts between one form of employment and another. On the other hand are effects upon the disposition of income gained from

productive efforts - its division between consumption and saving, between the consumption of the many kinds of goods and services, between the numerous ways of saving and investing - and the disposition of income gained from investment.

Taxes are levied to finance the public employment of resources. Conceptually resources should be employed in public use to the point where their marginal net return in such use declines to the point where it is no greater than the marginal return on their use in the private sector. In principle, marginal net returns in public use should be calculated after allowance for any positive or negative effects government activity has upon activity in the private sector. Thus, in the case at hand, if personal income taxation changes willingness to work, the change would be viewed as a positive or negative effect depending upon the direction of the change and whether it is considered favourable or unfavourable. (Similarly the benefits of activity in the private sector, conceptually, should be measured after allowing for any positive and negative effects such activity might have upon the public employment of resources.)

The tax system is a powerful tool that can be and is used to try to reduce fluctuations in economic activity. The progressive income tax serves as an automatic stabilizer, increasing tax liabilities when incomes are high and decreasing them when they are low when the schedule of rates is left unchanged. By altering capital cost allowances on new investment by business, prospective after-tax profits can be altered as a means of influencing the level and timing of capital expenditures. Tax rates for all the major taxes - personal income, corporate profits, sales taxes - can be varied as a means of controlling private spending in the interests of economic stabilization.

Finally, a tax system must be evaluated from an administrative viewpoint. Is it workable? Does it carry out the intent of the legislators? To what extent is the distribution of tax liabilities the outcome of the running battle between private initiative, which seeks to find tax loopholes, and the legislatures supported by their legal and accounting advisors who attempt to close them? Are too many

of the good legal and accounting brains of the land preoccupied with offsetting activities of opening and closing loopholes in the tax system rather than lowering the costs of production and distribution? Is the law frustrated by expense account living, entertaining, do-it-yourself activity, etc.? The reward for tax avoidance is directly related to tax rates, a condition which argues for keeping rates as low as possible. Avoidance tends to create a cumulative process in which rates are raised to maintain revenues, which in turn increases the quest for loopholes, which when successful requires a further increase in rates to maintain revenues, etc. This means that in the interest of administration as well as equity, the tax base should be as broad as possible. Exemptions should be minimized.

Tax evasion is also encouraged by high rates of taxation and is another reason for making and keeping the tax base as broad as possible.

The tax system should also be designed with a view to minimizing the costs of its routine operations - both for the government and for taxpayers complying with the law.

A P P E N D I X "B"

Excerpt from Submission of Retail Council of Canada to Federal Royal Commission on Taxation on the topic of Tax Incentives

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While tax incentives appear to be a useful economic tool, it must be clearly understood that they cannot operate in isolation. Investment decisions are dependent upon a wide variety of factors of which tax implications may be only one. The selection of a plant site, for example, is based on a review of market areas, transportation costs, availability of skilled labour and many other factors. Accelerated depreciation or tax holidays available in certain areas would be only one factor and in some cases perhaps a highly artificial one, in such a situation. Such incentives may in fact ultimately prove to be a disadvantage if they cause a company to locate in an area economically unsuited to its particular operation.

The Council is not seriously concerned that large numbers of businessmen will move to designated areas for new plant construction irrespective of other more important economic factors, and thereby create a higher cost economy. On the contrary, it is much more likely that these incentives will be enjoyed by businesses which would have been located in the designated area in any event. The obvious results may be that the incentive, introduced at some tax cost to the treasury, will fail to influence business to invest in projects that would otherwise not have been undertaken.

In summary, the Council believes that many of the recent incentives offered in the form of tax savings or deferals are of little significance in stimulating economic activity. On the other hand serious objections can be raised to this approach to economic planning.

1. While the Council acknowledges that the tax system can be used to reduce fluctuations in economic activity, the tax incentives offered should be available to all taxpayers. Incentives which are discriminatory, unrelated to ability to pay, or are highly selective as among taxpayers are to be deplored.

2. Depreciation incentives are of varying degrees of significance depending upon the nature of each particular industry. Industries requiring a high capital investment are generally not likely to offer prospects of greatly increased employment.

3. Most incentives have traditionally favoured manufacturing and processing industries. As employers of labour, such industries are becoming less significant. The greater the proportion of jobs provided by the service industries, the less is the justification for according special treatment to only the manufacturing industry.

4. Tax holidays for new industries locating in designated areas can be criticized on the grounds that they may be enjoyed most by those taxpayers who are least in need of assistance. Industries which for the first few years after commencing operations can expect very little income would, under this incentive, receive little or no benefit.

Since tax incentives must offer significant tax savings if they are to be at all attractive to business, the tax holiday approach may well result in a substantial inequity in tax treatment between similar taxpayers.

The Council is conscious of the difficult problems caused by unemployment in Canada, particularly in areas where unemployment has remained at high levels. We are concerned, however, that the recent incentive measures may only cause a redistribution of unemployment, and in the long run, if successful in encouraging uneconomic activity, could well result in increased overall unemployment. Measures which encourage industry to locate in uneconomic areas are contrary to what the long-term objectives of sound economic planning should be. Canada has unemployment today largely because much of Canadian industry is unable to compete on world markets. Government policy should therefore be directed towards a reduction in the costs of these Canadian products, and in measures which stimulate demand on the domestic market.

A P P E N D I X "C"

Excerpt from Submission of Retail Council of Canada to Federal Royal Commission on Taxation on the topic of Sales Taxes and the Level of their Incidence

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Notwithstanding the greater administrative simplicity inherent in the present manufacturers' sales tax, arguments have been advanced in favour of a change to a wholesale or a retail sales tax. Of these, some at least are open to serious qualification and are discussed below.

1. Valuation for tax purposes

> It is argued that since many manufacturers sell their products at varying prices, depending on the particular class of customer (wholesaler, retailer or consumer), complex calculations are frequently required so that the tax will be based in all cases on a deemed price to a wholesaler. Valuations of this type are seldom perfect and may in some cases result in distortions in the relative competitive positions of similar products. By changing the tax to a higher level of application these distortions often disappear.

We believe that the seriousness of this price distortion argument has been overstated. It has been our experience that the Department of National Revenue has wherever possible taken great care to avoid the creation of inequitable pricing situations. The Department has, for example, permitted the use of the "unlicenced wholesale branch method" as a means of overcoming valuation problems. (It should be noted that later in this submission the Council recommends that this method be granted legislative sanction.)

While it is possible that whatever distortions result from "fair value" calculations would be reduced somewhat in a tax levied at the wholesale level, the Council believes that it would be inequitable to base the tax only on the price paid by retailers. Such a system would permit large retail chains to purchase merchandise at a significantly lower tax cost since the bulk of their buying is done directly from manufacturers. On the other hand, smaller retailers would pay what amounts to an additional tax on the wholesalers' markup. To avoid this inequity, it would be necessary to tax direct sales from manufacturers to retailers at deemed wholesale prices. This of course is the same basic valuation difficulty which is now faced in taxing at the manufacturers' level. Accordingly, the Council believes that a change in the incidence of tax to the wholesale level, with the immense administrative problems that such a shift would create, would not result in any significant improvement over the present method.

2. Pyramiding

> Here the argument is that, at present, pyramiding of the manufacturers' sales tax arises because distributors set their selling prices by applying a fixed percentage markup to their purchase prices. The tax-induced component of the price to the consumer is, it is argued, larger than the amount of the tax charged to the manufacturer.

In this respect, of course, sales taxes are not unique. As long as there is a markup there is pyramiding of all components of the price charged to the retailer for goods, and the increase in any component of this price seemingly is magnified.

But this is only the initial effect. Profit margins are not immutable. They cannot go on rising with every increase in costs without attracting additional resources into distribution. Existing firms will be induced to expand and new firms to enter the field. That is, the normal forces of competition will tend to restrain pyramiding of sales taxes just as they tend to restrain the pyramiding of any other components of cost.

The process of adjustment of course takes time. The interim effect upon prices from the pyramiding of the sales tax, however, is small. Consider the case where the manufacturers' sales tax has remained constant for some time so that there has been opportunity for the forces of competition to eliminate the markup effect. The manufacturer raises the pre-tax sale price of a product from, say, $10 to $11; sales tax is applicable at 10%; the retailer's markup is 20%. The effect of pyramiding can be seen by comparing the change in the price to the consumer with the change that would have occurred had the same amount of tax been assessed at the retail level. In the case at hand the effect on the consumer price of tax pyramiding is 2 cents, or 0.14% of what the retail price would be. Meanwhile it is the whole 10% increase in the amount of the markup which works to increase competition and reduce markups.

3. Publicity given to amount of tax

> Here the argument is that it is salutary for a purchaser to be reminded of the tax element incorporated in the price of the goods he buys each time he makes a purchase.

It is of course generally desirable that citizens in a democracy be aware of their tax burdens. It does not follow, however, that a retail sales tax is an advantageous way of informing them. A purchase-by-purchase reminder is redundant in an age of highly developed communication. Such a reminder is also misleading. The amount of taxes paid does not indicate their final effect upon price. Nor is the purchase-by-purchase reminder of the cost of government accompanied by a similar reminder of the benefits produced and distributed by government. Imbalanced knowledge about costs and benefits tends to create a distorted view of the appropriate role of government and an under-appreciation of its contribution to community welfare. Meanwhile those who for intelligent political decision-making wish to learn the extent of sales taxes and other taxes, along with data on the volume and composition of government expenditure can readily obtain such information. In the case of purchasers who are indifferent about developing informed views about government activity and its financing, the availability of less misleading and imbalanced information on public finance is scarcely harmful.

Purchase-by-purchase reminder of tax being paid by the consumer, unaccompanied as it must be by disclosure of the benefits it finances, is a source of irritation and inconvenience to the purchaser. It is conceivable that it would have greater effects upon consumption than an equal amount of tax collected at the manufacturer level. Consumption would be restricted less and shifted less from taxed to exempt goods. There would also be less tendency to engage in do-it-yourself production, which reduces specialization of effort, to avoid tax on the labour content of finished goods.

4. Disturbance to price structure

> It is argued that tax changes are less disturbing to the price structure. When taxes are levied at the retail level a change in the tax rate has fewer pricing ramifications. A change in the manufacturers' sales tax normally means changes to all subsequent prices in the production-distribution process.

The point is valid, but usually it is of widespread significance only when there is a change in the tax rate and such changes are infrequent. In the past 30 years the rate has been changed only three times. Price changes can of course result from changes in exemptions,

although these changes are usually of limited significance. Moreover, of total prices that must be set, the vast majority of them are retail prices. The reduction in price adjustments would be confined to the minority of prices that are set at the manufacturer and wholesale level.

5. Consolidation with provincial sales taxes

> It is argued that moving federal tax to the retail level would be a first step towards consolidation of federal and provincial sales tax collection facilities. Now that all but two provinces levy a retail sales tax uneconomic duplication of administration costs is widespread. If provincial sales taxes were made uniform in coverage and regulations (but not necessarily in rate) the federal and provincial taxes could be collected at the same time. It has been further suggested that upon such consolidation provinces with established retail sales tax collection facilities would administer the tax in their areas on behalf of the Federal government. Alternatively, the Federal government could administer the tax for both levels of government. Although it would sacrifice administrative advantages from centralization, the former arrangement has been advocated because it would mean more provincial autonomy.

A questionable feature about this proposal is that it requires uniform provincial legislation and regulations to be effective. Agreement of all the provinces could be difficult to achieve. Extending the sales tax to services would widen the area over which agreement would have to be reached. Moreover, entering into a uniform agreement with a number of other provinces means a sacrifice of some of the autonomy which the provinces now have.

Transitional problems

In choosing where in the production-distribution process to apply and collect sales tax it is not enough to compare the pros and cons of collection at one level or another. The fact that the tax is currently established at the manufacturers' level must be recognized and any disrupting effects from a change evaluated. One important question is whether, upon a transfer of the tax to retailers, manufacturers would reduce their post-tax prices, and if so would they reduce them by the amount of the tax now levied? If they would not, the transfer of the tax would have the effect of increasing prices to consumers.

When it is proposed that the federal sales tax be 'moved' to the retail level, it seems to be taken for granted that the whole of the tax saving at the manufacturer level would be reflected in lower manufacturer prices. This cannot be taken for granted.

Our experience has been that reductions in manufacturers' costs do not invariably result in an equal reduction of their prices. Moreover, it seems easy enough to make sense of this price rigidity in terms of the basic circumstances of Canadian manufacturing industry. It goes without saying that if the price rigidity is a natural result of the basic circumstances of Canadian manufacturing industry, then it cannot be expected to disappear in the future.

When this question of price rigidity is considered, the fundamental fact which must be taken as a starting point is that parts of Canadian manufacturing industry are highly concentrated (in the sense that most or all of the output is produced by a very small number of firms). This fact is well known and has been borne out by Rosenbluth's careful study of the matter. His conclusion is that in Canadian manufacturing industries "on the average, concentration is quite high"[1]. At the same time there is wide dispersion about the average (Rosenbluth) - which means that the quite high average reflects lower concentration in some industries and very high concentration in others.

Highly concentrated industries have good reasons to have inflexible prices. These reasons are different in different cases, depending on the degree of competition present. Concentration, to many people, implies effective price agreements between producers. Should an agreement exist, of course it would mean rigid prices. Concentration, however, by no means implies the existence of such agreements, and we consider them to be quantitatively insignificant, if they exist at all. What is important to demonstrate is that prices are likely to be inflexible in a concentrated industry characterized by competing producers.

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1. G. Rosenbluth, Concentration in Canadian Manufacturing Industries, 1957, Princeton University Press.
   Rosenbluth's data indicate how concentrated employment is in the different industries; but he points out that concentration of output and concentration of employment are highly correlated, and that concentration of output tends to be slightly higher than concentration of employment.

When a highly concentrated industry is freely competitive in the sense that each firm manoeuvres independently in attempting to make the best of its individual situation, each firm is likely to learn to fear its competitors' reactions to price changes. Because the industry's output is concentrated among a small number of firms, the individual firms are strongly affected, favourably or unfavourably, by one another's price policies. A firm which reduces its price is likely to find that its competitors retaliate by reducing theirs, rather than allowing it to take a substantial part of their business away from them. On the other hand, a firm which increases its price is likely to find that its competitors leave their prices unchanged and welcome the substantial extra business which is being pushed their way. "From the point of view of any particular producer this means simply that if he raises his price he must expect to lose business to his rivals..., while if he cuts his price he has no reason to believe he will succeed in taking business away from his rivals..."[1]. In these circumstances, price changes are likely to be infrequent. Of course the condition does not only discourage price reductions; prices would often remain unchanged even when everyone in the industry would prefer that they be higher.

That there is very considerable price rigidity in Canadian manufacturing to us seems certain and that therefore there are indeed components of the industry which are held to lower prices than they wish to charge. Depending upon the type of competitive situation that is involved, the producers concerned are restrained from moving to higher prices by fear of competitive reactions, or fear of government and public reactions. In such a situation any opportunity to (in effect) raise prices without "rocking the boat" is welcomed. Cost reductions, which can simply be absorbed with the prices being left undisturbed, are one such opportunity. Transfer of the federal sales tax away from the manufacturers' level to the retail level would provide an opportunity to increase profits without "rocking the boat" by simply not passing the whole of the tax saving on.

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1. P.M. Sweezy, "Demand Under Conditions of Oligopoly", Journal of Political Economy, 1939, pp. 568-573; reprinted in American Economic Association: Readings in Price Theory, 1953, pp. 404-409. The quoted sentence is from the second page of the article.

The cost of transferring the tax from the manufacturers' level, in terms of lost tax revenues, must also be taken into consideration. In estimating this cost the principle has been followed that the transition should impose no additional tax burden upon the consumer. In other words the new retail tax should not be applied to goods which have already been tax paid at the manufacturers' level. The Council believes that any other approach, which would require the double payment of tax at some stage during the transition, would be politically unacceptable.

The Council has estimated that the transition would result in an absolute loss of tax revenue of at least $300 millions. This amount is the Council's estimate of the amount of tax which has already been paid on retail and wholesale inventories on hand at any given date and which would need to be refunded in some way before these goods could be subjected to a retail sales tax. Alternatively, this amount represents the tax which would normally be collected in any three-month period, which is the average turnover period of retail inventories.

The refunding of this tax could be accomplished in a number of ways. Perhaps the most acceptable method would be to allow a refund to each retailer of the amount of tax already paid on his inventory on the date that the new retail tax is imposed. This procedure would require some arbitrary calculation since few retailers would be able to determine the actual tax content of their inventories. After establishing some reasonable basis under which refunds could be made, the Tax Department would then need to process and verify some 350,000 refund applications.

While this procedure might appear to be overwhelming, it seems preferable to some alternative methods which the Council has considered.

1. The declaration of a "tax holiday" for approximately three months, during which no sales tax would be imposed. This would enable the average retailer to dispose of his tax-paid inventories on hand before the retail tax commenced. Unfortunately no fixed period would be equitable to every retailer because of the wide range of turnover periods for different products. Such a procedure would allow windfall profits to some and substantial losses through double taxation to others.

2. Refunds of tax could be made to the manufacturers on sales made during a given period prior to the transition. The manufacturers would then be expected to pass these refunds on to their wholesale or retail customers. We believe that this alternative suffers from

the same weakness as the "tax holiday" approach, with its determination of an average refund period, plus the enormous administrative cost that it would impose upon manufacturers and wholesalers.

Enforcement and administration

The Council is convinced that the introduction of a federal retail sales tax would be possible only if the tax could be administered jointly with the provinces, either by provincial agencies or by a department of the federal government.

The Council believes that the administrative and enforcement problems to be faced by such an agency would be more difficult than those now encountered in the provincial sales tax field. This is largely due to the rate of tax which would be levied. We estimate that a federal retail sales tax of between 7% and 8% would be required to bring in sufficient revenue to compensate for the abandonment of the present manufacturers' sales tax. This would result in an overall retail sales tax ranging from 7% in Alberta and Manitoba to 11-13% in Quebec. Other provinces would have a tax rate of from 10% to 12%. (These rates would of course increase should the federal government place greater reliance upon sales tax as a source of revenue.) Problems of enforcement and administration now facing provincial governments, which to some extent can be minimized because of the low rate of tax, would then become much more significant at these higher levels.

The most serious of these problems result from the need to exempt from tax items that are generally regarded as necessities of life. Food is the one product category which is generally exempt from sales tax. Other products are exempt if purchased by licenced manufacturers as raw materials or as production materials. Exemptions of this type are allowed in order to prevent pyramiding of tax, on items that are used in the production of other taxable goods. Further exemptions are allowed to certain classes of consumers, on goods which are otherwise subject to tax.

In each type of exemption just mentioned problems of definition and interpretation frequently arise which require rulings by the taxation authorities, together with subsequent follow-up. We believe that problems of this nature are much more easily dealt with when they involve only the

manufacturers of the product in question. When taxing sales at the retail level, this problem of communication becomes much more difficult because of the large number of retailers normally stocking this item. Further, retailers are given the task of keeping themselves fully informed on sales tax developments affecting the full range of products carried for sale.

Enforcing the law is generally more difficult when exemptions are permitted. This statement is perhaps illustrated by the "cookie jar" approach followed by many smaller retailers in the collection and remittance of provincial sales taxes. In these cases, the retailer reports and remits only the amount of tax collected, which he usually keeps in a separate cash drawer. This approach is perfectly understandable in most cases since smaller retailers find it unnecessary and uneconomic to set up elaborate stock control and sales analysis systems. Yet the absence of these detailed records makes it almost impossible to determine whether tax had been collected on all sales of taxable merchandise. This possible evasion of tax becomes more significant as the number of exempt items increases.

If the enforcement agency is sufficiently well staffed to conduct regular field audits, a collection problem would exist in the event that unreported taxable sales are discovered. We question whether a tax of 10% to 12% of gross sales can be collected in all such cases, particularly when the vendor is a small independent merchant, and the sales in question might have been made over a number of years.

Finally, it is the Council's belief that as rates of tax go up there is greater incentive offered for the evasion of tax, and enforcement thus becomes more difficult. We recall that the federal government has already had some limited experience in the retail sales tax field, with the 25% luxury tax imposed during World War II. There were serious enforcement problems associated with the collection of this tax and we believe this factor was at least a consideration causing its repeal in 1949.